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Education loan sector in India: Product differentiation and specialised approach critical for profitable growth

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Summary

India has a large young population with low gross enrolment ratios (GER[1]) providing opportunity for the players in the education sector including education loan providers i.e. Banks and NBFCs. GER in higher education in India was about 25.2% for 2016-2017, whereas globally it varies from an average of 8% in sub-Saharan Africa to 75% in Europe and North America.

Socio-economic profile of the students and cost of education are the key factors driving education finance. Technical/professional courses including vocational courses entail higher fees as compared with general education which requires external financing. Furthermore, higher costs in privately-managed unaided colleges vis-á-vis government colleges also drive the requirement for external finance.

Currently, the sector is predominantly covered by the Public Sector Banks (PSBs) forming almost 95% of the total bank lending to the education loan sector. On account of lower ticket size of loans being disbursed by the PSBs, majority of them are getting classified as priority sector lending and are unsecured in nature. The delinquencies in the PSBs in this segment have been higher on account of loans being unsecured in nature and also as these loans are funded for graduation courses which have lower employment opportunities. The loan portfolio of PSBs has large regional disparities with higher proportion of portfolio outstanding in southern India, mainly Tamil Nadu and Kerala. However, this indicates that there is large untapped segment across India.

In recent years, there is emergence of NBFCs with specialised approach towards the education sector. They have been different in their approach in terms of financing the education loans as compared with the banks. They have presence across major cities in India and predominantly funding students for overseas education. The delinquencies in their portfolio are lower on account of higher proportion of their portfolio being secured in nature. In addition, they are funding overseas education, which provides more employment opportunities.

The education loan segment which is primarily been driven by government emphasis on providing finance to meritorious students requires a focussed approach towards designing the product to

[1] *GER : Gross Enrollment Ratio is a statistical measure used in the education sector to determine the number of students enrolled in school at several different grade levels and it is used to show the ratio of the number of students who live in that country to those who qualify for the particular grade level.*

maintain good asset quality. Lenders need to clearly define the parameters to assess each student loan separately rather than treating it simply as a priority sector loan. New scorecards are required to be developed and the existing ones need to be further fine-tuned to arrive at risk pricing commensurate with the profile of the student and employability. The regulatory framework also needs some modifications which allow the lender some flexibility in deciding the loan terms including collateral requirement based on the student profile and employment prospects of the student.

The budgetary announcement in 2017-18 by the government has put emphasis on improvement and revitalising infrastructure and systems of education including higher education including access to finance. Thus, the stage is set for growth momentum in the higher education sector with government support. However, this requires enhanced private sector participation including NBFCs and banks. The private sector has to participate in the financing of students in the higher education system with specialised approach to create growth momentum and also control delinquencies at reasonable levels for sustainable profitable growth.

Introduction

Education and development are closely related, as education provides inputs for economic growth among which knowledge is an important one. Development of knowledge is based on the quantity and quality of education system available, particularly of higher education, in a country.

Higher Education Scenario in India

As per the survey,[2] there are 864 universities, 40,026 colleges and 11,669 standalone institutions in India imparting higher education. Majority of the colleges in India are privately managed (77.8%), of which majority are unaided colleges. Total enrolment in higher education has been estimated to be 3.5 crore students with 1.9 crore boys and 1.6 crore girls. *Gross Enrolment Ratio in higher education in India is 25.2% for 2016-2017 which is calculated for the age group of 18-23 years.*

Education loan sector in India

Development of higher education depends on various factors, among which finance plays a major role. Bank credit has an important role in promoting the education and development of skilled professionals required by an emerging market economy such as India. The idea to encourage education loans was first coined through the introduction of education scheme formulated by Indian Banks Association (IBA) in 2001.

Financing for higher education is being met through various sources including direct student loan from banks and other financial institutions, parents borrowings through other channels including from friends and relatives, credit card borrowings, loan against property and other unorganised sources. The overall education loan portfolio is about Rs.80,000 crore comprising mainly of scheduled commercial banks (~Rs.73,000 crore), co-operative Banks (~Rs.2,000 crore) and NBFCs (Rs.5,000 crore).

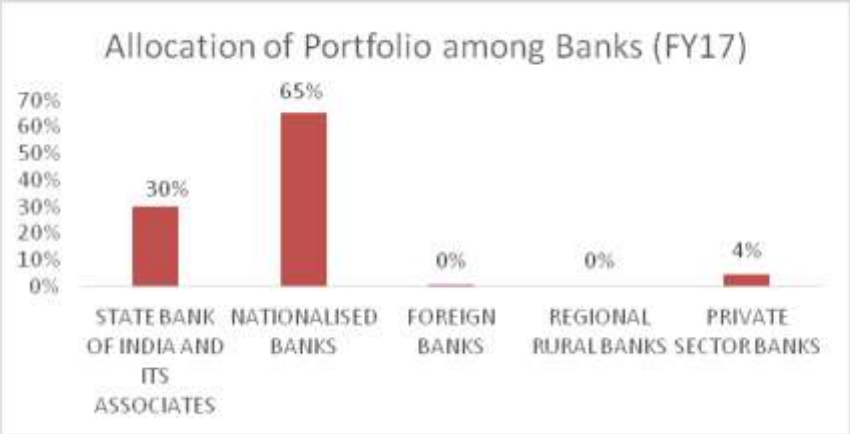
[2] All India Survey on Higher Education (2016-2017)

Key characteristics of education loan sector

Higher participation of public sector banks (PSBs)

The education loan sector in India has primarily been driven by the public sector banks on the back of government emphasis on providing financing to meritorious student from the lower socio-economic backgrounds.

The nationalised banks, including the SBI group, have the highest proportion forming around 95% of the education loan portfolio amongst the banks. The resistant towards disbursements in this sector is seen in the trend from the low participation of the foreign as well as private sector banks forming minimal share in the education loan portfolio. NBFC participation is lower as compared with the banking sector.

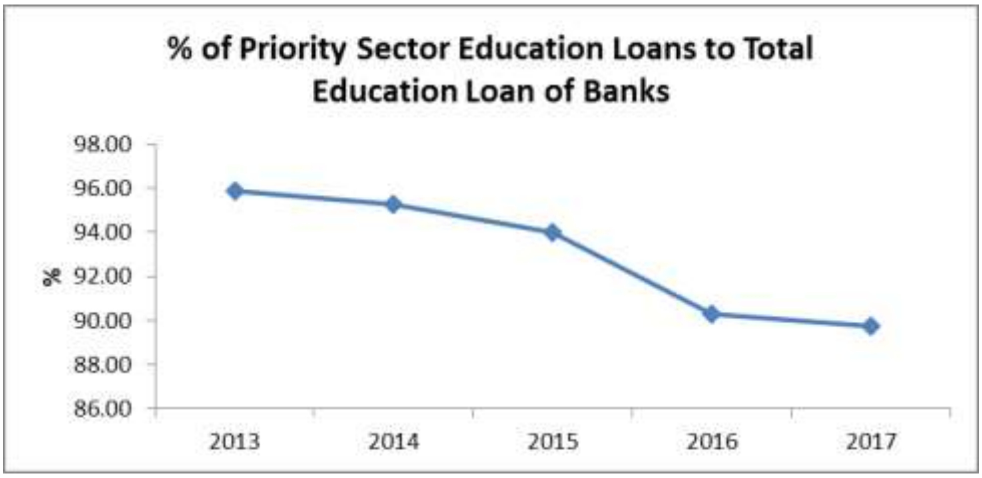


Source: RBI

Higher proportion of the education loan portfolio of banks within the priority sector lending category

Education loan scheme was introduced in 2001 by banks for facilitating higher education for poor and meritorious students. Initially, this scheme covered students studying in India as well as abroad with a maximum ceiling of Rs.7.5 lakh in India and Rs.15 lakh for abroad studies. Currently, education loans up to Rs.10 lakh are eligible to be classified as priority sector loan, irrespective of the sanctioned amount.

As majority of the loan book of bank comprises of loan with ticket size less than Rs.4 lakh which falls in the category of priority sector lending. Education loans under the priority sector lending stood at around 89% in FY17 (refers to the period April 1 to March 31) compared with the total educational loan portfolio of the banks. However, it has been observed that the ratio of priority sector loans to total educational loan portfolio has been on a decreasing trend from almost 95.86% in 2013 to 89.75% in 2017. However, there is no compulsory prescribed limit to banks for education loans segment under priority sector lending guidelines unlike in case of other segments i.e. agriculture (18%).



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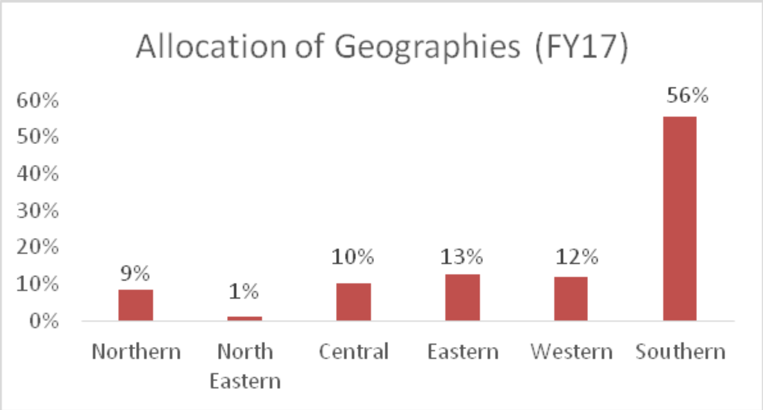


Source: RBI

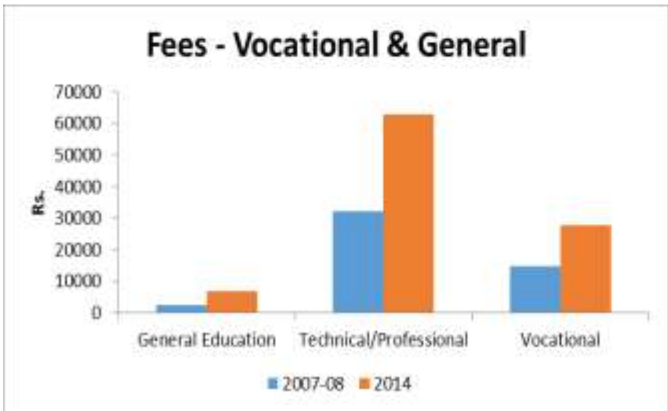
Large regional disparities in education loan portfolio of banks

The distribution of the education loan portfolio by the banks shows large regional disparities. Southern India forms around 56% of the total education loan portfolio of the banks.

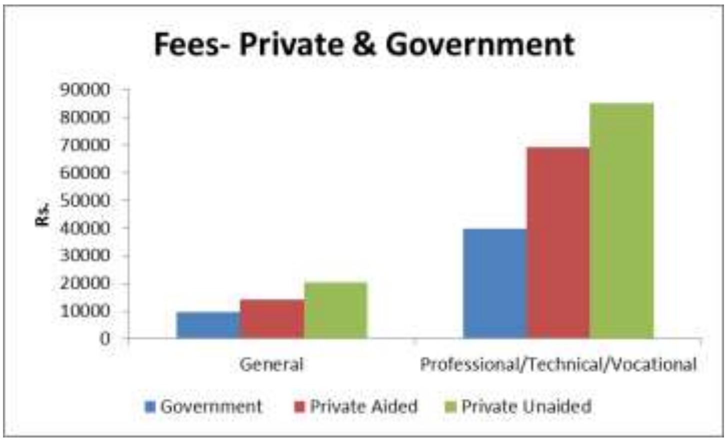
Amongst the states, Tamil Nadu and Kerala together account for 36% of the outstanding education loan portfolio. The other states which contribute higher to the education loan portfolio of banks include Maharashtra, Karnataka, Andhra Pradesh and Telangana. The education loans are skewed towards some regions mainly on account of higher literacy levels and students inclination to pursue higher education mainly technical courses. Furthermore, the availability of the government schemes, access to finance and availability of ready educational infrastructure are other key aspects which skew the ratio towards these regions.

Increasing cost of education driving education finance

Higher education in technical/professional fields including vocational courses entails higher fees as compared with general education. As per the National Survey Sample Report 2014, average annual expenditure on technical/professional and vocational education was about 9 times and 4 times that of general education.



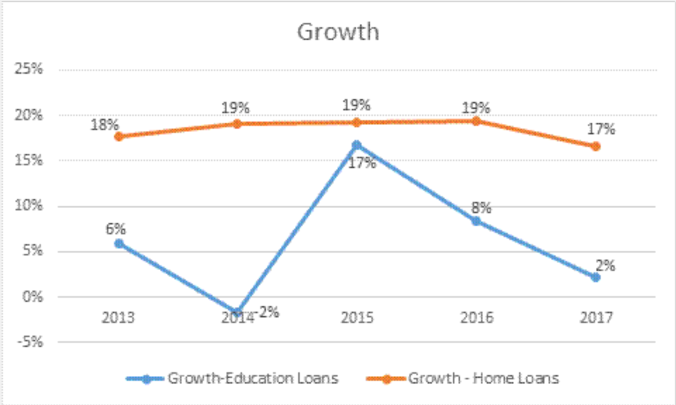
The fact that majority of the colleges in India are privately managed and unaided has led to higher requirement for finance from banks. As per the National Survey Sample Report 2014, average annual expenditure on technical/professional education in private aided and unaided colleges varied between 1.5 and 2.5 times to that of Government institutions.



The rising costs of obtaining a college degree has meant that for many students the only way to finance their education is via student loans. Students from lower socio-economic background are more likely to access bank finance considering the costs associated in completing the course.

Lower growth in education loan segment vis-à-vis other asset classes

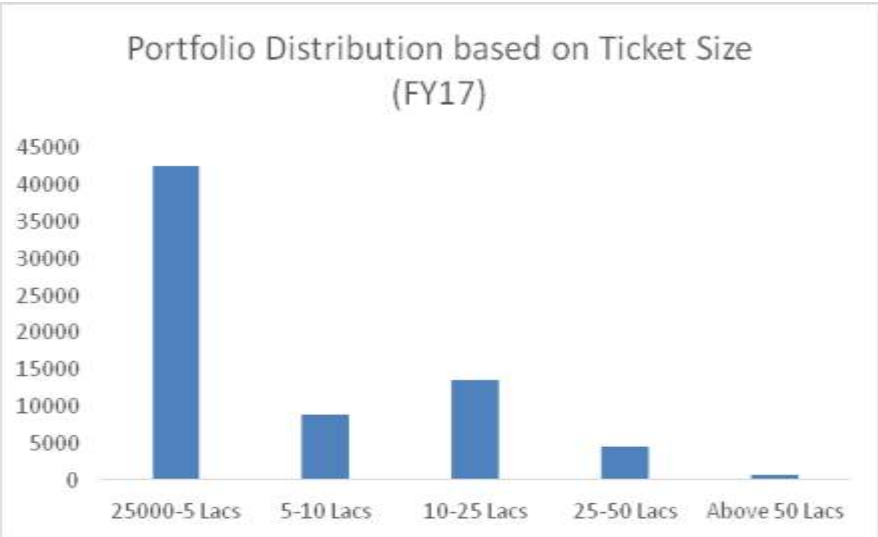
The education loan portfolio growth has been low despite the opportunities in the education segment. One major factor could be higher delinquencies experienced by banks and very few specialised lending institutions in this segment.



Source: RBI

Higher delinquencies in the education loan portfolio of public sector banks

As per the IBA scheme for education loan from banks, there is no security and margin requirement for loans upto Rs.4 lakh.



For loan amounts ranging from Rs.4 lakh to Rs.7.5 lakh, banks may seek third party guarantee and for loans above Rs.7.5 lakh, tangible collateral security of suitable value, along with the assignment of the future income of the student for payment of instalments, is required. It has been observed from the distribution of portfolio that the maximum loan portfolio is within Rs.5 lakh category indicating that majority of the portfolio is unsecured in nature primarily on account of the IBA scheme which does not allow any collateral upto Rs.4 lakh of education loan.

Source: RBI

The total value of non-performing loans for the public sector banks in the education sector has grown from Rs.3,536 crore in March 2015 to Rs.5,192 crore in March 2017 spiking the NPA ratio to 7.67% in FY17 from 5.70% in FY15. While the problem of higher delinquencies is pan India, two states primarily Kerala and Tamil Nadu, which have higher proportion of loan portfolio, show higher delinquencies. As per the information derived from the State Level Bankers Committee meeting minutes, Kerala and Tamil Nadu showed GNPA% above 10% as compared with the overall delinquencies at 7.67% at Pan India Level. Other States such as Andhra Pradesh, Telangana and Madhya Pradesh, Gross NPA% were around 5%. The key reason for higher delinquencies is that majority of the loans are unsecured in nature.

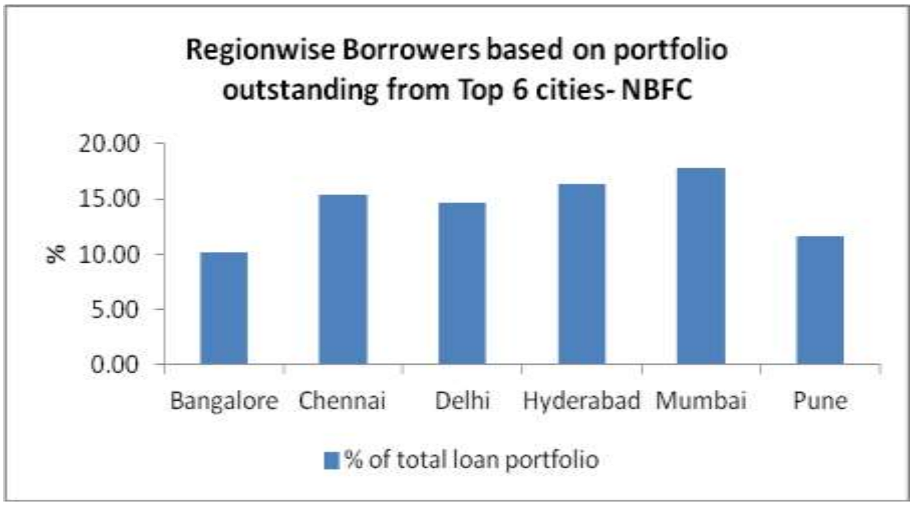
There could also be a pattern of student's delinquencies vis-à-vis level of higher education. The delinquencies are likely to be higher in undergraduate courses vis-à-vis post graduate courses as employment opportunities (rate of returns/future earnings) are commensurate with the financial costs on account of lower competition in those segments. Further, reputation/brand and technical superiority of the college in imparting education (which also has a bearing on the employability) seems to be directly correlated to the debt servicing. Students or their parents who are conscious of maintaining financial discipline including their credit history are also likely to report lower delinquencies. The delinquencies are higher in cases wherein the repayments are being done by the students rather than the parent who are also helping with the debt repayments.

In the recent times, PSBs are making an effort to reduce NPAs and in the process selling the delinquent loans to asset restructuring companies (ARCs).

Growing emergence of NBFCs with specialised approach towards education sector

The portfolio of the NBFC sector within the education loan segment is lower as compared with the banks. However, there has been emergence of specialised NBFCs in this segment. The overall portfolio of the NBFCs in this segment is around Rs.5,000 crore as on March 31, 2017. They have focussed on building expertise in the segment and have grown their portfolio at a good pace in the segment along with maintaining a healthy asset quality. There are few NBFCs operating in this segment and some have started recently. In this study, the performance of NBFC segment represents the performance of the few large players and compares the same with the performance of the banks in education loans.

The NBFCs have focussed in key cities across India wherein the students are more likely to pursue higher studies mainly post graduate courses and are looking for opportunities outside India.



Source: CARE Ratings

Almost 90% of the portfolio of the NBFCs is spread across 6 cities viz. Mumbai, Delhi, Chennai, Bangalore, Pune and Hyderabad. Mumbai occupies a major chunk of the portfolio followed by Hyderabad and Chennai. The portfolio is widely dispersed as compared with the portfolio of PSBs wherein higher proportion of the portfolio was from Southern India mainly Tamil Nadu and Kerala.

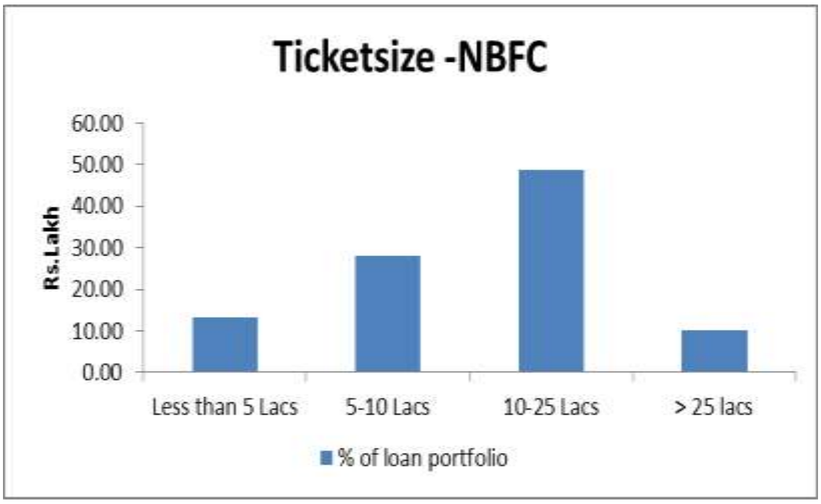
The funding for education loans by the NBFCs is concentrated towards post graduate courses mainly Engineering, Management and Master of Science. Together, these courses continue to hold approximately 80% of the outstanding portfolio. This is in contrast to the loans by PSBs which are mainly towards funding under graduate courses.

NBFCs have clear preference for overseas studies as compared with the domestic funding. Domestic funding is very low as compared with total funding by the NBFCs. This is also due to the fact that students prefer abroad for pursuing post graduate courses mainly management and engineering/science. In terms of overseas education, USA is the preferred destination for pursuing higher education and the trend is increasing y-o-y.

The ticket size of NBFCs is very different to that of banks with majority of loans in case of PSBs being in the range below Rs.4 lakh which do not require any collateral. Whereas, in case of NBFCs majority of portfolio (76% of the total portfolio) is more than Rs.5 lakh ticket-size. This is primarily because NBFCs cater to students going for education abroad which is relatively more expensive.

On account of higher ticket size of loans, around 52% of the portfolio of NBFCs is secured in nature. The security is primarily in the form of property or fixed deposits.

Thus, the key difference in terms of business model followed by the NBFCs and banks is lending for overseas education and higher proportion of secured lending. This has helped the NBFCs to maintain asset quality at reasonable levels. The asset quality of the secured lending portfolio of the NBFCs is expected to mirror the asset quality of housing loan as majority of the security is in the form of property.



Source: CARE Ratings

Conclusion

The education loan segment which is primarily driven by government focus on education sector requires a specialised approach towards designing the product to maintain good asset quality. The players need to clearly define the parameters to assess each student loan separately rather than treating it as priority sector loan. Clear scoring card needs to be developed or needs to be further fine-tuned to arrive at risk pricing commensurate with the profile of the student. The profile of the student should take into account education background, past educational performance, university credentials to which the student has applied and employability of the student. Extra caution is required especially in the loans of smaller ticket size that are unsecured.

The regulatory framework also needs some modifications which allow the lender some flexibility in deciding the loan terms including collateral requirement based on the student profile and the employability of the student.

The penetration in education loan market is only 20% compared with the higher education expenditure. Hence, there is still a large untapped segment which can lead to significant growth for lenders and creation of sustainable model for the players in this segment.